

California's 2013-14 Budget



April 20, 2013

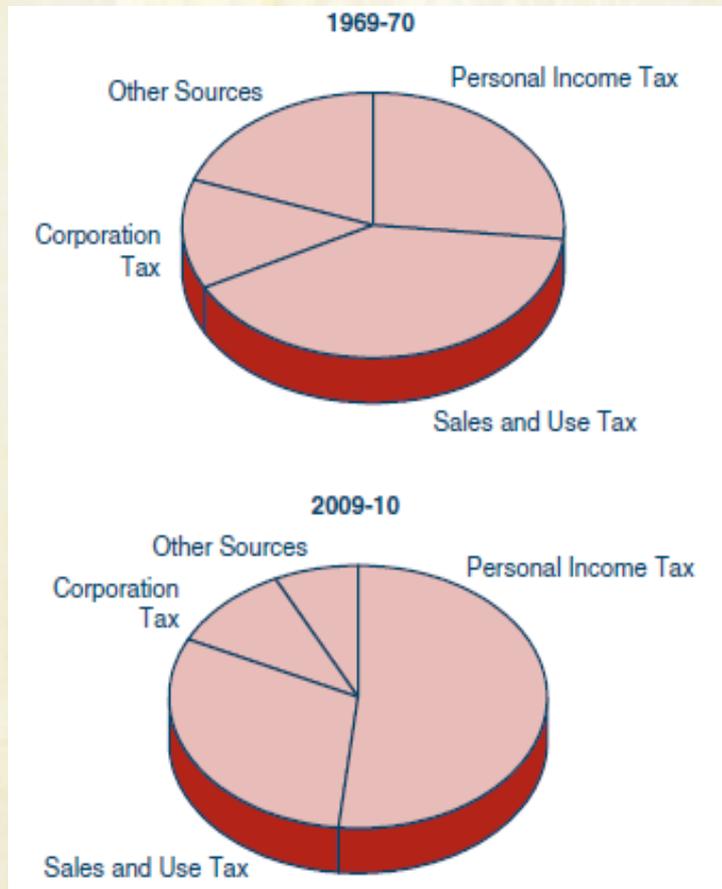
Roadmap for Today's Presentation

- Start with context on the budget, revenues, and expenditures.
- Consider the dynamics of this year's budget process.
- Discuss several key proposals in the Governor's January budget.
- Review several key considerations with the proposed budget.
- Finish with questions/answers.

State Budget at a Glance

- 161 different state departments.
- \$138.6 billion in proposed total spending (\$97.7 billion State General Fund).
- Roughly 670 different special funds.
- About 357,000 authorized positions.
- Over 70 percent of General Fund not spent at the state level and instead passed on to other governmental bodies at the county, city, and special district level.

Composition of Revenues

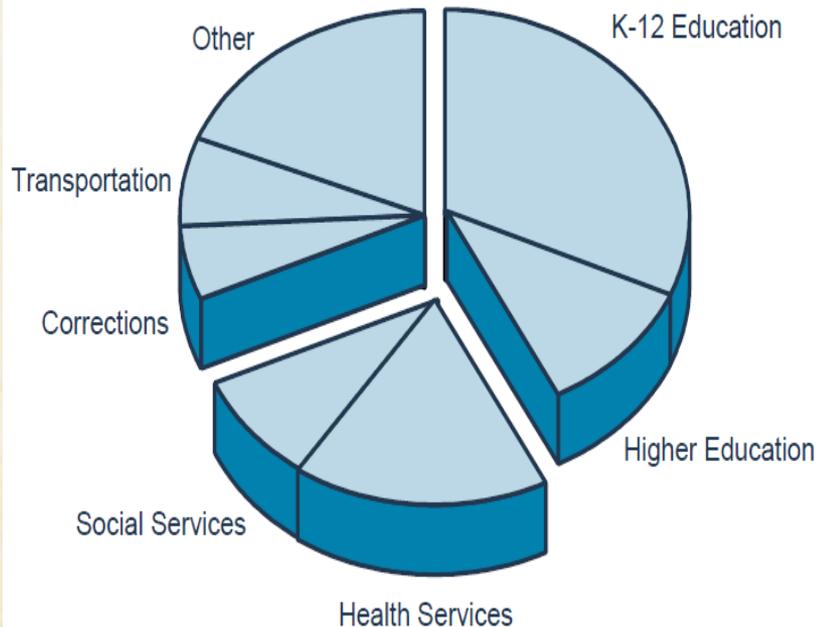


- Over the past four decades, personal income tax revenues to the General Fund have increased dramatically—rising from 27 percent to 51 percent of General Fund revenues.
- This growth is due to growth in real incomes, the state's progressive tax structure, and increased capital gains.
- The reduced share for the sales tax reflects in part the increase in spending on services, which generally are not taxed.

Composition of Expenditures

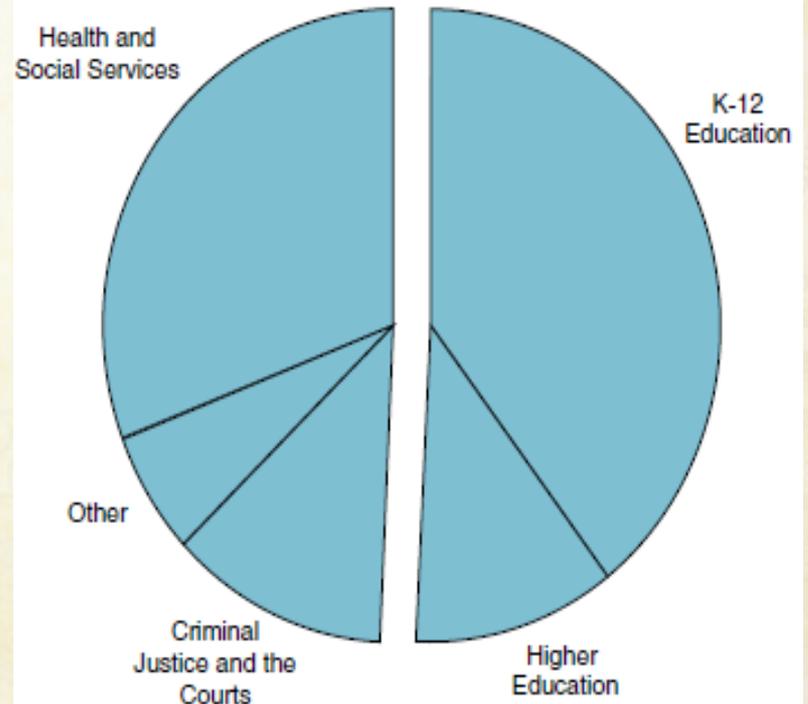
Education and Health and Social Services Dominate Spending

2000-01



Education Makes Up Half of State Spending

General Fund—2011-12



2013 Budget Dynamics

- After years of budget cutting and fiscal turmoil, California's budgetary situation is largely stable and the state's credit rating is improved...
- ...but many uncertainties remain:
 - Economic conditions improving, but still shaky.
 - Future actions in Washington on “sequestration” and federal budget could affect the state's budget.
 - State's revenues are more dependent than ever on Personal Income tax, which is volatile and difficult to project, and thus...
 - ...April 15 revenue collections—and the accompanying May Revision—could alter the situation.

2013 Budget Dynamics (con't.)

- If everything holds close to current projections, State's budget looks to have surpluses in the longer-term...
- ...but the longer-term plans embedded in the Governor's Budget, including greater investment in K-12, higher education, healthcare, and debt buy-down, expend most of the future surpluses.
- While Governor's Budget proposals would reduce "Wall of Debt," considerable amount remains, as well as longer-term fiscal liabilities, like retiree health, State Teachers Retirement System, etc.

2013 Budget Dynamics (con't.)

- Governor's Budget assumes a \$1 billion reserve (relatively healthy, but still equivalent to only about 1% of revenues), but does not assume any deposits into the Prop. 58 Budget Stabilization "rainy day" Account over the next 4 years...
- ...and given current projections and the Governor's proposals, to add to the rainy day fund would require spending less than proposed on things like higher education, health, debt buy-down, or by making cuts or raising revenues.

2013 Budget Dynamics (con't.)

- Intricacies of Prop. 98 will require that a vast amount of future General Fund revenue growth must go to K-14 education—a good thing, but...
- ...that leaves less for other General Fund programs and priorities, such as Health & Human Services, higher education, etc.
- Governor's Budget begins some important funding restorations, particularly in K-12 education and higher education, and expands health care coverage for the uninsured, but...

2013 Budget Dynamics (con't.)

- ...does little to restore previous difficult cuts to the “safety net” and other programs.
- Many state employee contracts expire this year, and the budget makes no assumptions about collective bargaining agreements, so...
- ...any new contract costs that are bargained will need to be paid for.
- Many budget-related issues still pending before state and federal courts (worth several hundreds of millions of dollars), and the outcomes of cases could change dynamics substantially.

How Does the Governor Pay Down the “Wall of Debt”?

- Mostly modest payments in 2013-14, more payments in the out-years.
- Biggest payments are automatic (Economic Recovery Bonds), or have limited alternative use, like Prop. 98 funds, which can only go for education.
- The most discretionary areas of payments are for special fund borrowing, local government mandates, and other state deferrals—and the bulk of those payments are in the out-years.

Governor's "Wall of Debt" Payments (billions of dollars)

	<u>Current Wall</u>	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>What Remains</u>
Deferrals to schools, CCCs	\$8.2	\$2.0	\$3.0	\$3.1	\$0.1	--
Economic Recovery Bonds	5.2	1.5	1.6	1.7	0.3	--
Borrowing: Special Funds	4.1	0.6	0.8	2.2	0.6	--
Mandate payments	4.9	--	--	0.2	2.2	2.5
Underfunding of Prop. 98	2.4	--	0.2	--	2.1	--
Deferred Medi-Cal payments	1.7	0.1	0.3	0.1	--	1.1
Deferred state payroll costs	0.7	--	--	--	--	0.7
Deferred payments to PERS	0.4	--	--	--	0.4	--
Borrowing: transportation	<u>0.2</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>--</u>	<u>--</u>
	\$27.8	\$4.2	\$6.0	\$7.3	\$5.8	\$4.3

What About Revenue Collections?

- **\$6.2 billion up:** As of April 18, personal income tax receipts were about \$6.2 billion above projections for the current fiscal year.
- **But caution:** LAO and DOF advise caution, some (perhaps most) of the additional 2012-13 receipts likely are connected to taxable income “accelerated” from 2013 (or later) back to 2012 due to the lower federal tax rates that were in effect at the time.
 - If maintained, these accelerations may result in increased 2011-12 and 2012-13 state revenue above projections, but potentially result in a decrease in revenues that would otherwise have occurred in 2013-14 (and in the out years).
- **And then there is Proposition 98...**

Revenues and Impact of Proposition 98

- LAO also cautions that the improved revenue may not help the state's financial bottom line in the current year because the revenue boost could result in a major increase in the state's Proposition 98 school funding minimum guarantee in 2012-13 by a similar amount, maybe as much as 90%, to pay off “Maintenance Factor” obligations.
- Going forward, the greater the year-to-year increase in revenues, the greater the Proposition 98 guarantee.

Many Fiscal Liabilities Still on the Long-Term Horizon

Federal loans for Unemployment Ins:	\$10 billion
State retiree health benefits:	62 billion
State employee pensions:	39 billion
Teacher pensions:	65 billion
UC employee pensions:	13 billion
Judges' pensions:	<u>3 billion</u>
Total:	<i>\$191 billion</i>

Key Budget Proposals: K-14 Education (Proposition 98)

- Overall, increases by \$2.8 billion, or about 5%
- Pays down deferrals (\$1.9 billion), year one of a four year plan.
- Transitions to new K-12 funding formula (\$1.6 billion) – “Local Control Funding Formula.”
- General purpose money for CCCs (\$197 million).
- Allocates Prop. 39 money for K-14 schools/colleges energy efficiency (\$450 million).
- Augmentation for Adult Education (\$300 million).
- Additional funding for K-12 mandate block grant (\$100 million).

K-12 Local Control Funding Formula

- Major restructuring of state funding for schools districts, charter schools, and county offices of education.
- Replaces existing Revenue Limit and Categorical Program funding with simple formula: uniform per-pupil rates and supplemental funding for certain groups of students.
- New formula begins in 2013-14; 7 year phase in.
- When fully implemented, all districts would receive more funding than they do today, but...
- ...that is partly a function of the projected growth in Proposition 98 and restoration of Revenue Limit and COLA funds.

K-12 Local Control Funding Formula

Governor's proposal has some strengths...

- Relatively simple & transparent.
- Heightens state focus on educationally disadvantaged students.
- Draw closer linkage of funding to costs.
- Provides flexibility to address local priorities.
- Places emphasis on students, not on complying with spending rules.

K-12 Local Control Funding Formula

...but also some weaknesses

- Doesn't consider what is "adequate" funding level for all students.
- Limited accountability provisions to ensure that funding is spent for targeted students.
- Excludes two of the largest, most outdated categorical programs.
- Does not protect investments in facilities.
- Major policy changes proposed in conjunction with the budget, which is required to pass by June 15.

Key Budget Proposals: *Higher Education*

- Overall, increases by about 5%.
- Mostly base increases in the 3 segments.
- Proposes no tuition increases in UC, CSU, or CCC.
- Proposes multi-year plan to increase state support for 3 segments.
- Proposes to cap number of units that state will subsidize.
- Designates funds in all 3 segments to expand distance education.
- Proposes to move Adult Education to CCCs.

Key Budget Proposals: *Health*

- Proposes full implementation of federal Affordable Care Act (ACA).
- Sets aside \$350 million for preliminary implementation of required changes under the ACA.
 - Assumes enactment in a Special Session of the Legislature.
- Assumes California will, in fact, expand Medi-Cal to uninsured (optional to states under U.S. Supreme Court decision).
 - Offers two different options to pay for it in the long-term, both of which require capturing savings counties will experience as a result of drop in county costs for indigent care.
 - Assumes that this implementation would take some time.

Key Budget Proposals: *Other*

- ***CalWORKs***: Includes \$143 million for expanded job services.
- ***Courts***: Provides \$200 million for court operations, but redirects the same amount from court construction funds to maintain same General Fund savings.
- ***Corrections***: Continues implementation of the “Blue Print,” but does not include any changes relative to recent federal court filings on prison population caps.
- ***In-Home Supportive Services***: Assumes implementation of existing law cuts, but make no new cuts.

Key Budget Proposals: *Other (con't.)*

- ***Veterans Affairs:*** Provides funding to open two new Veterans Homes, in Fresno & Redding.
- ***State Employees:*** Existing contracts fully funded; no funds included for salary or benefit increases that might come about as a result of new contracts.
- ***Enterprise Zones:*** Budget includes \$60 million in revenue from recent changes in regulations which eliminate “retro-vouchering.”
- ***State’s Cash Position:*** Much improved; no new deferrals of payments to schools or local governments.

Key Considerations

- May Revision is the next process milestone; followed by June 15 constitutional deadline.
- Governor's priority for new \$\$ – proposed augmentations for higher education and health.
- The “Wall of Debt” – should other debts be a higher priority for pay off?
- What about a multi-year approach to budgeting, given longer term revenue growth and uncertainties?

Key Considerations (con't.)

- How does the state balance the notion of greater long-term fiscal capacity against all of the budgetary uncertainties (revenues, the economy, federal funding)?
- What is the priority for making deposits to the “rainy day fund?”
- Does the state need to address the other, longer-term liabilities (retiree health, STRS, etc.)?
- And what about federal sequestration and the federal budget? How might that affect California?

Questions and Answers